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TAGS: ECON EINV EFIN ELAB ETRD KTDB PGOV OPIC USTR RP
SUBJECT: Philippines: 2009 Investment Climate Statement, Part One

REF: 08 STATE 123907

¶1. Part One of PostQs 2009 Investment Climate Statement is transmitted in paragraph 2, in accordance with reftel instructions.

¶2. Begin text:

2009 Investment Climate Statement -- The Philippines

Openness to Foreign Investment

The Government of the Philippines (GRP) generally acknowledges the importance of foreign investment to economic development. The GRP established the Board of Investments (BOI) to assist foreign and domestic investors with regulatory requirements, incentives, and market guidance. Legal restrictions, regulatory inconsistency and lack of transparency, however, persist in many sectors. GRP regulatory authority remains weak or ambiguous. Foreign business representatives often cite corruption as a serious impediment to investment. Commercial disputes are often difficult to resolve quickly or satisfactorily in the understaffed, complex, and delay-prone judicial system. In addition, the GRP has not adequately addressed other key issues like inadequate public infrastructure and electric power rates. Despite these problems, many foreign investors in the Philippines maintain long-term commitments to the market and have prospered.

The GRP is receptive to suggestions and criticisms from the private sector. Many foreign and domestic businesses work through industry associations to support economic reform. The American Chamber of Commerce of the Philippines promotes a socio-economic and philanthropic agenda, identifying investment opportunities and barriers, and offering possible solutions to problems. Through its Investment Climate Improvement Project, The Chamber pinpoints problems in the Philippine investment environment, assesses their relative importance to the investment climate and works toward finding and implementing practical and effective solutions. The Chamber has continued to produce advocacy papers, sometime jointly with other foreign chambers, on economic and political issues.

-- GENERAL PROVISIONS FOR FOREIGN INVESTMENT:

The Foreign Investment Act (R.A. 7042, 1991, amended by R.A. 8179, 1996) liberalized the entry of foreign investment into the Philippines. Under the Act, foreign investors are generally treated like their domestic counterparts and must register with the Securities and Exchange Commission (SEC) (in the case of a corporation or partnership) or with the Department of Trade and Industry's Bureau of Trade Regulation and Consumer Protection (in the case of a sole proprietorship). Investors generally find this process to be slow, but nondiscriminatory. The GRP has some foreign investment incentive programs, which are described below in the section "Performance Requirements and Incentives." The Philippines does screen potential foreign investments.

-- RESTRICTIONS ON FOREIGN INVESTMENT:

The 1991 Foreign Investment Act provides for two "negative lists" (List A and list B), collectively called the "Foreign Investment Negative List," enumerating areas where foreign investment is restricted or limited. The restrictions stem from a constitutional provision, Section 10 of Article XII, which permits Congress to reserve to Philippine citizens certain areas of investment and Section 11 of the same article which limits foreign participation in public utilities or their operation. The Foreign Investment Act requires the Philippine government to update and publish the negative list every two years. The Philippine government is scheduled to release a new list (the eighth Negative List) in January 2009. These restrictions are viewed as a significant factor in the Philippines' poor record of attracting foreign investment relative to neighboring economies. Waivers are not available under the Negative List.

List A enumerates investment sectors and activities for which foreign equity participation is restricted by mandate of the Constitution and specific laws. For example, the practice of licensed professions such as engineering, medicine, accountancy, environmental planning, and law are fully reserved for Philippine citizens. Other investment areas reserved for Filipinos include retail trade enterprises (with paid-up capital of less than $2.5 million, or less than $250,000 for retailers of luxury goods); mass media (except recording); small-scale mining; private security; utilization of marine resources, including small-scale utilization of natural resources in rivers/lakes/bays & lagoons; and, manufacture of firecrackers and pyrotechnic devices.

The Philippine government allows up to 20 percent foreign equity

participation in private radio communications networks. Up to 25 percent foreign ownership is allowed for enterprises engaged in employee recruitment and for public works construction and repair, with the exception of build-operate-transfer and foreign -funded or foreign-assisted projects (that is, projects that benefit from foreign aid, for which there is no upper limit on foreign ownership). Foreign ownership of 30 percent is allowed for advertising agencies, while 40 percent foreign participation is allowed in natural resource exploration, development, and utilization (although the President may authorize 100 percent foreign ownership for large scale projects).
Foreign investors are limited to 40 percent equity in educational institutions, public utilities operation and management, commercial deep-sea fishing, GRP procurement contracts, adjustment companies, operations of build-operate-transfer projects in public utilities, and ownership of private lands. For rice and corn processing, foreign equity is limited to 40 percent, with the exception that 100 percent foreign participation is allowed with the proviso that the foreign investor shall divest a minimum of 60 percent of their equity to Philippine nationals within a 30 year period from start of operation.
Foreign ownership of retail trade enterprises with paid-up capital of $2.5 million but less than $7.5 million is now allowed, provided that the initial investment to establish a store is more than $830,000, or specializing in high end or luxury products, provided that the paid up capital per store is not less than $250,000.
Enterprises engaged in financing and investment activities that are regulated by the Securities and Exchange Commission, including securities underwriting, are limited to 60 percent foreign ownership.

List B enumerates areas where foreign ownership is restricted or limited (generally at 40 percent) for reasons of national security, defense, public health, safety, and morals. Sectors covered include explosives, firearms, military hardware, massage clinics, and gambling. This list also seeks to protect local small- and medium-sized firms by restricting foreign ownership to no more than 40 percent in non-export firms capitalized at less than $200,000 and for domestic market enterprises that involve advanced technology or employ at least 50 direct employees with paid-in equity capital of less than $100,000.

In addition to the restrictions noted in the "A" and "B" lists, firms with more than 40 percent foreign equity that qualify for Board of Investment incentives must divest to the 40 percent level within 30 years from registration date or within a longer period determined by the Board of Investments. Foreign-controlled companies that export 100 percent of production are exempt from this requirement. As a general policy, the Department of Labor and Employment allows the employment of foreigners provided there are no qualified Philippine citizens who can fill the position. Board of Investment-registered companies may employ foreign nationals in supervisory, technical, or advisory positions for five years from registration, extendable for limited periods at the discretion of the Board of Investments. Top positions and elective officers of majority foreign-owned enterprises (i.e., president, general manager, and treasurer or their equivalents) are exempt from these restrictions.

-- FINANCIAL SERVICES:

The Act Liberalizing the Entry and Scope of Operations of Foreign Banks in the Philippines (R.A. 7721, 1994) limited to ten the number of new foreign banks that could open full-service branches in the Philippines. All ten licenses have been issued. These foreign banks are limited to six branch offices each. The four foreign banks operating in the Philippines prior to 1948 were also allowed to open up to six branches. Subject to certain criteria, R.A. 7721 allows a foreign banking institution up to 60 percent ownership in a locally incorporated subsidiary. As a general rule, a non-bank foreign investor or foreign bank that does not meet the criteria stipulated in R.A. 7721 and its implementing regulations, is limited to 40 percent ownership. For rural banks, only foreign banks that meet the criteria stipulated in R.A. 7721 may invest; otherwise, foreign ownership is prohibited.

A seven-year window under the General Banking Act (R..A. 8791, signed in May 2000) allowing foreign banks to acquire up to 100 percent of one locally incorporated commercial or thrift bank (with no obligation to divest later) closed in June 2007. The Bangko Sentral ng Pilipinas (the central bank) imposed a moratorium on new bank licenses in September 1999 which remains in effect. Micro-finance institutions are exempted. Another limitation on foreign ownership is a requirement that majority Filipino-owned banks should, at all times, control at least 70 percent of total banking system resources. Cooperative banking remains completely closed to foreigners.

The insurance industry was opened up to 100 percent foreign ownership in 1994. However, minimum capital requirements increase with the degree of foreign ownership. As a general rule, only the state-owned Government Service Insurance System may provide coverage for government-funded projects. Administrative Order 141, issued in August 1994, also required proponents and implementers of build-operate-transfer projects and privatized government corporations to secure their insurance and bonding requirements from the Government Service Insurance System, at least to the extent of the government's interests.
Membership in the Philippine Stock Exchange is open to foreign-controlled stock brokerages incorporated under Philippine law. Securities underwriting companies not established under Philippine law may underwrite Philippine issues for foreign markets, but not for the domestic market. The Lending Company Regulation Act -- signed into law in May 2007 to establish a regulatory framework for credit enterprises that do not clearly fall under the scope of existing laws -- requires majority Philippine ownership for such enterprises.

Although there are no foreign ownership restrictions regarding the acquisition of shares of mutual funds, current law restricts membership on boards of directors to Philippine citizens.

-- LAND OWNERSHIP:

The 1987 Constitution bans foreigners from owning land in the Philippines. The Investors' Lease Act (R.A. 7652, 1994) allows foreign companies investing in the Philippines to lease a contiguous land parcel of up to 1000 hectares for 50 years, renewable once for another 25 years, for a maximum 75 years.
In mid-2003, Republic Act 9225 (Citizenship Retention and Re-Acquisition Act of 2003 or the Dual-Citizenship Act) allowed natural-born Filipinos who had undergone naturalization as citizens of a foreign country to re-acquire Philippine citizenship. The dual-citizenship holder is entitled to full rights of possession of land and property as a Philippine citizen.

Deeds of ownership are difficult to establish, poorly reported, and poorly regulated. The court system is not able to settle cases in a timely manner.

Foreigners are allowed 100 percent ownership of companies involved in large-scale exploration, development, and utilization of mineral resources. Total mineral production up to the third quarter of 2008, was valued at $1.1 billion, fell by about 27% from the same period in 2007 due mainly to flagging nickel prices. Some $500 million in investments were registered in 2007, which is about 60% of the capital invested in new mining projects since 2004.

-- TRENDS AND PROBLEM AREAS:

Philippine gross capital formation, estimated at between 15 and 16 percent of Gross Domestic Product, ranks among the lowest in Asia. Net foreign direct investment improved yearly from less than $500 million in 2003 to $2.9 billion in 2007, but contracted by more than 50 percent year-on-year in 2008. Overall, net FDI flows have averaged less than $1.6 billion annually since 2000, trailing many of the Philippines' neighbors. The country captured less than 5 percent of total net investment flows to Southeast Asia over the past eight years and accounts for less than 3.5 percent of the foreign investment stock in the region. The Philippines will need to compete more aggressively for risk-averse capital and investments during a period of global economic uncertainty, but has recorded sliding global competitiveness and anti-corruption rankings. The American and other foreign chambers in the country also continue to urge the Philippine government to review legal barriers to trade and investment and further open up the Philippine economy.

Trade infrastructure urgently needs attention, including Bureau of Customs operations, the nation's inter-island shipping, and port facilities. Infrastructure spending remains subject to corrupt practices in allocation, procurement, contracting, and implementation, with a significant portion of the budget wasted. Anti-corruption vigilance and enforcement has been weak. Congestion and pollution in the country's major cities persist, most notably in Manila.
Investors cite high electricity costs in the Philippines and power shortages as areas of concern. The GRP follows a policy of

liberalizing the power sector through the sale of government generation and distribution assets and through support for alternative energy sources to reduce dependence on imported fuels.

-- SANCTITY OF CONTRACTS:

Questions over the general sanctity of contracts in the Philippines have clouded the investment climate. The judicial system has a weak track record in this area. A more detailed discussion of this issue is found in the section entitled "Dispute Settlement."

-- STOCK EXCHANGE:

The Philippines is generally open to foreign portfolio capital investment. A more detailed discussion is provided in the section entitled "Efficient Capital Markets and Portfolio Investment."

-- PRIVATIZATION:

The Privatization Management Office, under the Department of Finance, is the technical and implementing agency tasked to carry out the day-to-day government responsibilities of the privatization program. The Office serves as the marketing arm of the GRP for privatized assets, as well as government-owned and controlled corporations assigned for disposition, and is responsible for implementing the actual marketing/disposition program for government corporations, assets and idle properties. Apart from restrictions under the Foreign Investment Negative List (detailed above), there are no separate regulations that discriminate against foreign buyers. The bidding process appears to be transparent, though the Supreme Court has twice overturned high profile privatization transactions to foreign buyers.
The Power Sector Assets and Liabilities Management Corporation is mandated to sell 70% of the government-owned National Power Corporation's generating assets. Eight years after the signing of the Electric Power Industry Reform Act, the Philippine government will close the year 2008 having privatized more than 70% of the generation assets, one of the three necessary conditions needed to trigger the implementation of the open access and retail competition provisions of the electricity reform law.
-- PUBLIC INFRASTRUCTURE:

The Build-Operate-Transfer Law provides the legal framework for large infrastructure projects and other types of government contracts. Consistent with constitutional limitations on foreign investment in public utilities, franchises in railways/urban rail mass transit systems, electricity distribution, water distribution, and telephone systems must be awarded to enterprises that are at least 60 percent Philippine-owned. American firms have won contracts under the law and similar arrangements, mostly in the power generation sector. However, because of weaknesses in planning, preparing, tendering, and executing private sector infrastructure projects, lingering ambiguities about the level of guarantees and other support provided by the government, and other uncertainties pertaining to the general enabling framework for private sector participation in infrastructure, there is relatively low interest by foreign firms in pursuing projects in the Philippines at present.

Conversion And Transfer Policies

There are generally no restrictions on the full and immediate transfer of funds associated with foreign investments, foreign debt servicing, and the payment of royalties, lease payments, and similar fees. To obtain foreign exchange from the banking system for debt servicing, repatriation of capital, or remittance of profits, the foreign loans and foreign investment must be registered with the central bank. There are no restrictions on obtaining foreign exchange, and foreign exchange can be bought and sold outside the banking system. There is no mandatory foreign exchange surrender requirement imposed on export earners and other foreign exchange earners such as overseas workers. The exchange rate is not fixed and varies daily in response to market forces. Central bank intervention is targeted mainly at smoothing volatility.
To curb foreign exchange speculation and volatility, the central bank requires a 90-day minimum holding period for foreign investments in peso time deposits to be eligible for registration. Pre-termination before the prescribed period would result in the cancellation of the registration and the investor will not be allowed to purchase foreign exchange from banks for repatriation and remittance purposes. However, the peso proceeds from the pre-terminated time deposits may be invested in other instruments and registered anew.

Expropriation And Compensation
Philippine law allows expropriation for public use or in the interest of national welfare or defense. In such cases, the GRP offers compensation for the affected property. Most expropriation cases involve acquisition for major public sector infrastructure projects. In the event of expropriation, foreign investors have the right under Philippine law to remit sums received as compensation in the currency in which the investment was originally made and at the exchange rate at the time of remittance. However, agreeing on a mutually acceptable price can be a protracted process.

There are laws that mandate divestment (to 40 percent foreign equity) by foreign investors. The Omnibus Investment Code specifies a 30-year divestment period for non-pioneer foreign-owned companies that accept investment incentives. Pioneer enterprises are registered enterprises engaged in the manufacture and processing of products or raw materials that are not yet produced in the Philippines in large volume. Non-pioneer enterprises refer to all registered producer enterprises not included in the pioneer enterprise list. Companies that export 100 percent of production are exempt from the divestiture requirement. The Retail Trade Liberalization Act (R.A. 8762, 2000) requires retail establishments that are capitalized at $2.5 million or more and/or that do not specialize in luxury products to offer at least 30 percent of their equity to the public within eight years from the start of operations.

Dispute Settlement - Investment Disputes

Investment disputes are infrequent, but when they occur it can take years for parties to reach final settlement. A number of GRP actions in recent years have raised questions over the sanctity of contracts in the Philippines and have clouded the investment climate. Recent high-profile cases include the GRP-initiated review and renegotiation of contracts with independent power producers, court decisions voiding allegedly tainted and disadvantageous build-operate-transfer agreements and challenging the extent of foreign participation in large-scale natural resource exploration activities (such as mining).

-- LEGAL SYSTEM:

Many, perhaps most, foreign investors view the inefficiency and uncertainty of the judicial system as a significant disincentive for investment. Although the judiciary is constitutionally independent of the executive and legislative branches, it faces many problems, including understaffing and corruption. Critics also charge that judges rarely have a background in or thorough understanding of market economics or business, and that their decisions stray from the interpretation of law into policymaking. The GRP is pursuing judicial reform with support from foreign donors, including the U.S. Government, the Asian Development Bank, and the World Bank.
The Philippines is a member of the International Center for the Settlement of Investment Disputes and of the Convention on the Recognition and Enforcement of Foreign Arbitrage Awards. However, Philippine courts have, in several cases involving U.S. and other foreign firms, shown a reluctance to abide by the arbitral process or its resulting decisions. Enforcing an arbitral award in the Philippines can take years.

-- BANKRUPTCY LAW:

The Securities Regulation Code of 2000 assigned jurisdiction over debt payment suspension and corporate rehabilitation cases to regional trial courts designated by the Supreme Court as commercial courts. The Supreme Court's "Interim Rules of Procedure on Corporate Rehabilitation," which took effect in December 2000, provided for specific periods and deadlines for compliance with procedural requirements (including court approval/disapproval of a rehabilitation plan). However, in some cases judges reportedly have not enforced the deadlines stipulated in the rules. Investors have also expressed concern over a "cram down" provision that allows the courts to approve a rehabilitation plan despite opposition from majority creditors "if, in [the court's] judgment, the rehabilitation of the debtor is feasible and the opposition of the creditors manifestly unreasonable." In December 2008, the Supreme Court approved revised "Rules of Procedure on Corporate Rehabilitation," which succeeded the 2000 "interim" rules effective January 16, 2009 (http://sc.judiciary.gov.ph/rulesofcourt/2008 / dec/A.M.NO.00-8-10-SC.pdf). The more significant improvements include new provisions covering petitions for the approval of pre-negotiated rehabilitation plans carrying the endorsement of creditors holding at least two-thirds of the total liabilities of the debtor (including secured creditors holding more than 50 percent of the total secured claims and unsecured creditors holding more than 50 percent of unsecured claims); as well as the inclusion of provisions on the recognition of foreign proceedings.
Investors nevertheless strongly believe that reforms should go beyond procedural improvements and continue to push for comprehensive legislation to rationalize and update the Philippine bankruptcy/insolvency system. The current legal framework is a

mixture of outdated and sometimes inconsistent laws and judicial pronouncements.

Performance Requirements And Incentives

Book I, Investment with Incentives, of the Omnibus Investment Code (1987) prescribes incentives available to qualified firms engaged in preferred sectors and geographic areas included in the annual Investment Priorities Plan, administered by the Board of Investments. The 2008 Investment Priorities Plan presents a list of priority investment areas entitled to incentives into the following classes: preferred activities; mandatory inclusions; export activities; and the Autonomous Region in Muslim Mindanao List.

Preferred activities include projects in agriculture/agribusiness and fishery, infrastructure, tourism, research and development, engineered products, and strategic activities. Export activities cover the production and manufacture of non-traditional export products and services as identified under the Medium Term Philippine Development Plan. Mandatory inclusions are activities that require inclusion in the Investment Priorities Plan as provided for under existing laws. The Autonomous Region in Muslim Mindanao List covers priority activities independently identified by the Autonomous Region of Muslim Mindanao.

Screening mechanisms for companies seeking investment incentives appear to be routine and nondiscriminatory, but the application process can be complicated. Incentives granted by the Board often depend on actions by other agencies, such as the Department of Finance.

The basic incentives offered to all Board of Investment-registered companies include:

* Income tax holiday: new projects with "pioneer" status receive a six-year income tax holiday, with the possibility of an extension to eight years. New projects with non-pioneer status receive a four-year holiday with a possible extension to six years. New or expansion projects in less developed areas, regardless of status, receive a six-year income tax holiday. Expansion and modernization projects receive three years (limited to incremental sales revenue/volume). Enterprises located in less developed areas may secure a bonus year if: the ratio of total imported and domestic capital equipment to number of workers for the project does not exceed $10,000 per worker; the net foreign exchange savings or earnings amount to at least $500,000 annually for the first three years of operation; or indigenous raw materials used are at least 50 percent of the total cost of raw materials for the years prior to the extension unless the Board prescribes a higher percentage;

* Additional deduction for wages: for the first five years after registration, an additional deduction from taxable income equivalent to 50 percent of the wages of additional direct- hire workers is allowed, provided the enterprise meets a prescribed capital equipment-to-labor ratio set by the Board. Firms that benefit from this incentive cannot simultaneously claim an income tax holiday;

* Additional deduction from taxable income for necessary and major infrastructure works for companies located in areas with deficient infrastructure, public utilities, and other facilities: a company may deduct from its taxable income an amount equivalent to expenses incurred in the development of necessary and major infrastructure works. This deduction is not applicable for mining and forestry-related projects;

* Tax and duty exemption on imported breeding stocks and genetic materials and/or tax credits on local purchases thereof (equivalent to the taxes and duties that would have been waived if imported), for purchases made within ten years from a company's registration with the Board or from the start of its commercial operation;

* Exemption from wharf dues and any export tax, duty, impost, or fees on non-traditional export products made within ten years of a company's registration with the Board;

* Tax and duty exemption on importation of required supplies/spare parts for consigned equipment by a registered enterprise with a bonded manufacturing warehouse;

* Importation of consigned equipment for ten years from date of registration with the Board, subject to posting a re-export bond;

* Employment of foreign nationals: enterprises may employ foreign nationals in supervisory, technical, or advisory positions for a period not exceeding five years from registration (extendible for limited periods at the discretion of the Board of Investment) under simplified visa requirements. The positions of president, general manager, and treasurer of foreign-owned registered enterprises are not subject to this limitation. GRP regulations require the training of Filipino understudies for the positions held by foreigners. If foreign controlled, registered firms may indefinitely retain foreigners in the positions of president, treasurer, general manager, or their equivalents;

* Simplification of customs procedures for the importation of equipment, spare parts, raw materials and supplies and exports of processed products;

* Operation of a bonded manufacturing / trading warehouse subject to customs regulations.

* To encourage the regional dispersal of industries, Board of Investment-registered enterprises that locate in less developed areas, regardless of whether the companies are classified as "pioneer" or "non-pioneer," are automatically entitled to "pioneer" incentives. In addition, such enterprises can deduct from taxable income an amount equivalent to 100 percent of outlays for infrastructure works. They may also deduct 100 percent of incremental labor expenses from taxable income for the first five years from registration (double the rate allowed for Board-registered projects not located in less developed areas).

Detailed information and guidelines on the Philippines' 2008 Investment Priorities Plan can be obtained from the Board of

Investments website, www.boi.gov.ph.

-- INCENTIVES FOR EXPORTERS:

An enterprise with more than 40 percent foreign equity that exports at least 70 percent of its production may still be entitled to incentives even if the activity is not listed in the Investment Priorities Plan.

In addition to the general incentives available to Board of Investment- registered companies, a number of incentives provided under Book I of the Omnibus Investment Code apply specifically to registered export-oriented firms. These include:

* Tax credit for taxes and duties paid on imported raw materials used in the processing of export products;

* Exemption from taxes and duties on imported spare parts (applies to firms exporting at least 70 percent); and,

* Access to customs bonded manufacturing warehouses. Firms that earn at least 50 percent of their revenues from exports may register for incentives under the Export Development Act (R.A. 7844, 1994). Exporters registered under the Act may also be eligible for Board of Investment incentives, provided the exporters are registered according to Board of Investment rules and regulations, and the exporter does not take advantage of the same or similar incentives twice. Incentives under the Act include a tax credit that ranges from 2.5 percent to 10 percent of annual incremental export revenue.

The Board of Investments has been flexible in enforcing individual export targets, provided that exports as a percentage of total production do not fall below the minimum requirement (50 percent for local firms and 70 percent for foreign firms) needed to qualify for incentives. Board of Investment-registered foreign controlled firms that qualify for export incentives are subject to a 30 year divestment period, at the end of which at least 60 percent of equity must be Filipino-controlled. Foreign firms that export 100 percent of production are exempt from this divestment requirement.

-- PERFORMANCE AND LOCAL SOURCING REQUIREMENTS:

Performance requirements, usually based on an applicant's approved project proposal, are established for investors who are granted incentives, and vary from project to project. In general, the Board of Investments and the investor agree on yearly production schedules and, for export-oriented firms, export performance targets. The Board requires registered projects to maintain at least 25 percent of total project cost in the form of equity.
The Board generally sets a 20 percent local value-added benchmark when screening applications. The Board is flexible in enforcing local value-added ratios to which registrants commit in their approved project proposal, as long as actual performance does not deviate significantly from other participants in the same activity.

There are no local content requirements for cars, commercial vehicles, and motorcycles. However, to apply for registration with the Board of Investments and to qualify for incentives, new domestic and foreign assemblers must have a technical licensing agreement with the overseas completely-knocked-down suppliers to provide technical assistance and are required to invest at least $10 million in assembly operations and associated parts manufacture within one year to produce cars, $8 million for commercial vehicles, and $2 million for motorcycles.

Certain industries are subject to specific laws that require local sourcing:

* The Retail Trade Act of 2000 requires local sourcing for the first ten years after the law's effective date. During that period, at least 30 percent of the cost of inventory of foreign retail firms not dealing exclusively in luxury goods, and 10 percent of the inventory of firms selling luxury products, should consist of products assembled or manufactured in the Philippines.

-- INCENTIVES FOR REGIONAL HEADQUARTERS, REGIONAL OPERATING HEADQUARTERS, AND REGIONAL WAREHOUSES:

Book III of the Omnibus Investment Code (1987, amended by R.A. 8756, 1999) provides incentives for multinational enterprises to establish regional or area headquarters and regional operating headquarters in the Philippines. Regional headquarters are branches of multinational companies headquartered outside the Philippines that do not earn or derive income in the Philippines that act as supervisory, communications, or coordinating centers for their subsidiaries, affiliates, and branches in the region. The capital requirement for a regional headquarters is $50,000 annually to cover operatng expenses. Regional operating headquarters are branches established in the Philippines by multiational companies that may derive income from thir affiliates in the region and in the Philippinesby providing services such as general administraion and planning; business planning and coordination; sourcing/procurement of raw materials and coponents; corporate finance advisory services; maketing control and sales promotion; training and prsonnel management; logistics services; researchand development services, and product development; technical support and maintenance; data processng and communication; and business development.
Incentives to regional headquarters include exempton from income tax; exemption from branch profit remittance tax; exemption from value-added tax; sale or lease of goods and property and renditionof services to the regional headquarters subject t zero percent value-added tax; exemption from al kinds of local taxes, fees, or charges imposed y a localgovernment unit (except real property txes on land improvement and equipment); and value-dded tax and duty-free importation of training ad conference materials and equipment solely usedfor the headquarters functions. Regional operatig headquarters enjoy many of the same incentives asregional headquarters but, being income generating, are subject to the standard 12 percent value-added tax, applicable branch profits remittance tax, and a preferential 10 percent corporate income tax. Privileges extended to foreign executives working at these operationsinclude tax and duty-free importation of personal and household effects, multiple entry visas for the executive and his/her family, travel tax exemption, as well as exemption from

various types of government-required clearances and from fees under immigration and alien registration laws. Eligible multinationals establishing regional operating headquarters must spend at least $200,000 yearly to cover operations.
Multinationals establishing regional warehouses for the supply of spare parts, manufactured components, or raw materials for their foreign markets also enjoy incentives on imports that are re-exported. Re-exported imports are exempt from customs duties, internal revenue taxes, and local taxes. Imported merchandise intended for the Philippine market is subject to applicable duties and taxes.

-- GOVERNMENT PROCUREMENT

The 2003 Government Procurement Reform Act consolidated various procurement laws and issuances and called for simplified and standardized guidelines, procedures and forms across Philippine government agencies, government-controlled corporations, and local government units. The Act provided for simpler prequalification

procedures; more objective, nondiscretionary criteria in the selection process; the establishment of an electronic procurement system to serve as the single portal for government procurement activities; and other reforms to improve monitoring and transparency in public sector procurement. However, implementation has been uneven and inconsistent and U.S. and other foreign companies continue to raise concerns about irregularities in government procurement.

Philippine regulations require the public sector to procure goods, supplies, and consulting services from enterprises that are at least 60 percent Filipino-owned and infrastructure services from enterprises with at least 75 percent Filipino interest, for locally-funded projects. The Official Development Assistance Act authorizes the President to waive statutory preferences for local suppliers for foreign-funded projects/programs. Foreign donors have usually been able to implement their own procurement regulations under the provisions of the Act. The Build-Operate-Transfer Law (R.A. 6957 of July 1990, as amended in May 1994 by R.A. 7718) allows investors in projects and similar arrangements to engage the services of Philippine and/or foreign firms for the construction of infrastructure projects.

Executive Order 278 provides preferential treatment for Filipino consultants, stipulating that, as much as possible, the GRP should fund consultancy services for its infrastructure projects with its own resources and use local expertise. When Filipino capability is determined to be insufficient, Filipino consultants may hire or work with foreigners but should be the lead consultants. Where foreign funding is indispensable, foreign consultants must enter into joint ventures with Filipinos. In packaging public sector infrastructure projects, Executive Order 278 also provides that financial and technical capabilities of Filipino contractors be taken into account. Multilateral donor agencies report that their implementing partners have thus far been able to comply with donors' internal procurement guidelines, despite Executive Order 278. However, because an executive order has the force of law, the specter of problems arising in the future remains.
Executive Order 120, issued in August 1993, mandates a countertrade requirement for procurement by government agencies and government-owned or controlled corporations that entails the payment of at least $1 million in foreign currency. Implementing regulations set the level of countertrade obligations at a minimum of 50 percent of the import price and set penalties for nonperformance of countertrade obligations.

The Philippines is not a signatory to the WTO Agreement on Government Procurement.

-- PROPOSED CHANGES TO INVESTMENT INCENTIVES

There are currently more than 140 laws involving incentives offered by various investment promotion agencies, special incentive laws targeted at specific sectors and industry groups, and those granted to government-owned and controlled corporations under their charters. The government has supported incentives rationalization and a number of bills have been filed in the Philippine Congress toward this end. However, the scope and details of reform remain contentious. Proposals to phase out income tax holidays have been especially controversial and are opposed by business.

Right To Private Ownership And Establishment

The GRP respects the private sector's right to acquire and dispose of properties or business interests, although acquisitions, mergers, and other combinations of business interests involving foreign equity must comply with foreign nationality caps specified in the Constitution and other laws.

There are a few sectors closed to private enterprise, generally on grounds of security, health, or "public morals." The GRP controls and operates the country's casinos through the Philippine Amusement and Gaming Corporation and runs lotto/sweepstake operations through the Philippine Charity Sweepstakes Office.

Private and government-owned firms generally compete equally, although there are exceptions. The National Food Authority, a GRP agency, has at times been the sole importer of rice, though in 2008, the GRP ceded about half of all rice importation to the private sector. In some cases, GRP procurement guidelines favor Philippine over foreign-controlled firms. As a general rule, only the state-owned Government Service Insurance System may provide insurance for government-funded projects and government funds are kept in government-owned banks. Administrative Order 141 requires proponents and implementers of build-operate-transfer projects, as well as partially privatized government corporations, to meet insurance and bonding requirements from the government insurance system, at least to the extent of the GRP's interests.

The 1987 Constitution gives the GRP the authority to regulate or prohibit monopolies, and it also bans combinations in restraint of trade and unfair competition. However, there is no comprehensive competition law to implement this constitutional provision.

Protection of Intellectual Property Rights

Although the Philippines has established procedures and systems for registering claims on property (including intellectual property and chattel/mortgages), delays and uncertainty associated with a cumbersome court system continue to concern investors.

-- INTELLECTUAL PROPERTY RIGHTS:

The Philippines has made progress in recent years in protecting intellectual property rights, but enforcement continues to be problematic. U.S. manufacturers and suppliers should register their copyrights, trademarks, and patents with:

The Intellectual Property Office (IPO)
351 Sen. Gil J. Puyat Avenue
Makati City
fax: (63-2) 897-1724 / 752.5450 to 65 local 201 / 207
email: dittb@ipophil.gov.ph; mail@ipophil.gov.ph
website: http://www.ipophil.gov.ph/

Manufacturers and importers are also encouraged to register copyrights, trademarks, and patents with the Bureau of Customs to facilitate enforcement of rights. A list of Philippine lawyers and law firms specializing in intellectual property law is available from the U.S. Embassy Foreign Commercial Service (manila.office.box@mail.doc.gov).

In addition to its commitments under the World Trade Organization agreement on the Trade-Related Aspects of Intellectual Property Rights, the Philippines is a party to the following international intellectual property agreements: the Paris Convention for the Protection of Industrial Property, the Berne Convention for the Protection of Literary and Artistic Works, the Budapest Treaty on the International Recognition of the Deposit of Microorganisms for the Purposes of Patent Procedure, the Patent Cooperation Treaty; and the Rome Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organizations. Although the Philippines is a member of the World Intellectual Property Organization, and has acceded to the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty (known collectively as the WIPO Internet Treaties), which took effect in October 2002, the Philippine government has not yet enacted necessary amendments to its Intellectual Property Code that would fully implement the two Internet Treaties into domestic law.

The Intellectual Property Code (R.A. 8293, 1997) provides the legal framework for intellectual property rights protection in the Philippines. Key provisions of the Intellectual Property Code are:

--Patents: the Philippines uses a first-to-file system, with a patent term of 20 years from date of filing, and provides for the patentability of microorganisms and non-biological and microbiological processes. The holder of a patent is guaranteed an additional right of exclusive importation of his invention. A compulsory license may be granted in some circumstances, including if the patented invention is not being used in the Philippines without satisfactory reason, although importation of the patented article constitutes using the patent;

* Industrial Designs: the registration of a qualifying industrial design is for a period of five years from the filing date of the application. The registration of an industrial design may be renewed for not more than two consecutive periods of five years each;

* Trademarks, service marks, and trade names: prior use of a trademark in the Philippines is not a requirement for filing a trademark application. Well-known marks need not be in actual use in Philippine commerce or registered with the Bureau of Patents, Trademarks, and Technology Transfer. A Certificate of Registration shall remain in force for ten years. It may be renewed for periods of ten years at its expiration upon request and payment of a prescribed fee;

* Copyright: computer software is protected as a literary work. Exclusive rental rights may be offered in several categories of works and sound recordings. Terms of protection for sound recordings, audiovisual works, and newspapers and periodicals are compatible with the Agreement on the Trade-Related Aspects of Intellectual Property Rights;

* Performers Rights: "the qualifying rights of a performer . . . shall be maintained and exercised fifty years after his death." However, ambiguities exist concerning exclusive rights for copyright owners over broadcast and retransmission;

* Trade secrets: while there are no codified rules on the protection of trade secrets, GRP officials assert that existing civil and criminal statutes protect trade secrets and confidential information.

The Electronic Commerce Act (R.A. 8792, 2000) extends the legal framework established by the Intellectual Property Code to the internet. Other important laws defining intellectual property rights in the Philippines are the Plant Variety Protection Act (R.A. 9168, 2002), which provides plant breeders intellectual property rights consistent with the 1991 Union for the Protection of New Varieties of Plants Convention, and the Integrated Circuit Act (R.A. 9150, 2001), which provides WTO-consistent protection for the layout designs of integrated circuits.

In 2008, the Philippine Congress passed the Cheaper Medicines Act (RA 9502), which includes amendments to the Intellectual Property Code with respect to patent registration for pharmaceutical products. The Act places limitations on patent protection for pharmaceuticals, and significantly liberalizes the grounds for the compulsory licensing of pharmaceuticals.
Deficiencies in the Intellectual Property Code and other IP laws remain a source of concern. Weaknesses include unclear provisions relating to the rights of copyright owners over broadcast, rebroadcast, cable retransmission, or satellite retransmission of their works; and, burdensome restrictions affecting contracts to license software and other technology.

-- STATUS OF IPR ENFORCEMENT:

Significant problems remain in ensuring the consistent and effective protection of intellectual property rights. There are serious concerns regarding lack of consistent, effective and sustained IP enforcement in the Philippines. U.S. distributors continued to report high levels of pirated optical discs of cinematographic, musical works, computer games, and business software as well as widespread unauthorized transmissions of motion pictures and other programming on cable television systems. Trademark infringement in a variety of product lines is also widespread, with counterfeit merchandise openly available.

The Optical Media Act (Republic Act No. 9239 of 2004) regulates the manufacture, mastering, replication, importation and exportation of optical media. The implementing rules and regulations were signed in February 2005, establishing the Optical Media Board (formerly the Videogram Regulatory Board). The Board spearheads enforcement of the Optical Media Act and has jurisdiction over all optical media, regardless of content.

Although the Philippines deserves credit for passing the Optical Media Act, creating the Optical Media Board and stepping up raids, the Philippine government continues to lack aggressive prosecution of intellectual property rights violators, owing largely to problems that affect the judicial system as a whole. In general, Philippine government enforcement agencies are most responsive to those copyright owners who actively work with them to target infringement. Enforcement agencies generally will not proactively target infringement unless the copyright owner brings it to their attention and works with them on surveillance and enforcement actions. Joint efforts between the private sector and the National Bureau of Investigation and the Optical Media Board have resulted in some successful enforcement actions. The Philippine government has tried several different judicial approaches to handling intellectual property cases, but none have worked well due to lack of resources and heavy non-IP workloads. In addition, intellectual property cases are not considered major crimes and take a lower precedence in court proceedings. Because of the prospect that court action will be lengthy, many cases are settled out of court. There were three convictions in 2008, only one in 2007, nineteen convictions in 2006, and twenty in 2005. Since 2001, there have been sixty-four convictions for IP violations. Convicted intellectual property violators rarely spend time in jail, since the six year penalty enables them to apply for probation immediately under Philippine law.
Under the IP Code, the Intellectual Property Office has jurisdiction to resolve certain disputes concerning alleged infringement and licensing. However, the Intellectual Property Office's administrative complaint mechanisms appear to be no faster at resolving cases than the judicial system. Other agencies with IP enforcement responsibilities include: the Department of Justice; National Bureau of Investigation; Optical Media Board (for piracy involving any form of media on optical discs); the Bureau of Customs; and the National Telecommunications Commission (for piracy involving satellite signals and cable programming).

In 2006, the United States moved the Philippines from the Special 301 Priority Watch List (where it had been listed for 5 consecutive years) to the Watch List under Section 301 of U.S. trade law to acknowledge steps the Philippines has taken to strengthen its intellectual property regime. Following the announcement, the Philippine government pledged continued momentum and increased effort on intellectual property rights initiatives. However, counterfeit goods such as brand name and designer clothing, handbags, cigarettes, and other consumer goods remain widely available. Optical media piracy, including piracy of digital video discs and compact discs, also continues to be a problem. In addition, there are widespread unauthorized transmissions of motion pictures and other programming on cable television systems. The clandestine recording of movies in cinemas, piracy of books, cable television, and computer software also remain significant.

Transparency Of The Regulatory System

Agencies are required to develop regulations via a public consultation process, often involving public hearings. In most cases, this ensures some transparency in the process of developing regulations. New regulations must be published in national newspapers of general circulation or in the GRP's Official Gazette before taking effect. Enforcement of regulations is often weak and inconsistent. Regulatory agencies in the Philippines are generally not statutorily independent, but are attached to cabinet departments or the Office of the President. Many U.S. investors find business registration, customs, immigration, and visa procedures burdensome and a source of frustration. Some agencies (such as the Securities and Exchange Commission, Board of Investment, and the Department of Foreign Affairs) have established express lanes or "one-stop shops" to reduce bureaucratic delays, with varying degrees of success.

Kenney